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The Manufacturers Hanover
Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

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Like Pinocchio's Nose . . .

Of all the dismal economic news emerging during the past year, some of the worst has certainly originated in Washington. Scarcely a week has gone by in which estimates of the likely size of the Federal budget deficit in fiscal year 1982 and beyond were not revised upward substantially, sending tremors through the financial markets and keeping interest rates painfully high. And while it is hardly surprising that the budget outlook has deteriorated—what with the economy mired in recession, interest rates still riveted at lofty heights and deep, across-the-board cuts in personal income tax rates limiting revenue growth— what is astonishing is the rapidity with which Federal finances have worsened. In the space of just 12 months, deficit estimates have ballooned nonstop, prompting an embarrassing reversal of Administration tax policy, uncertainty in the financial markets and confusion among economists and the general public alike.

As shown in the table above, the Administration over the past year has frequently revised estimates of the budget deficit for fiscal 1982 and beyond, each time adding billions of dollars to the likely red ink total. After boosting the projected deficit for fiscal 1982 by $66½ billion (the *total* deficit in fiscal 1976 under President Ford), the government raised its estimates for fiscal 1983 from a deficit of $22.9 billion projected in July, 1981, to the $115 billion anticipated currently—a fivefold increase in only one year! What is more, estimates of total Federal and Federal-related borrowing needs, which include off-budget spending and the credit requirements of such Federally-sponsored agencies as the Federal Home Loan Banks, have also skyrocketed. For fiscal 1984, not only the size, but even the direction of the budget outcome has changed; where once a budget surplus was projected, there exists today a red ink total of at least $93 billion.

Nor have the estimates by the Congressional watchdogs of the budget process been any more accurate. Whereas the Congressional Budget Office one year ago expected that a budget surplus of $17.7 billion would be posted in fiscal 1983, five revisions later this has been transformed into a $146 billion deficit— a total change, so far, of approximately $165 billion. And if that seems large, the change in the outlook for fiscal 1984 is even more startling. Once again in the space of 12 months, initial estimates of a $76 billion surplus have been replaced by deficit projections now in excess of $150 billion (even after assuming passage of the proposed, three-year $98.9 billion tax increase package now making its way through Congress)—a huge $230 billion turnaround.

FEDERAL BUDGET DEFICIT PROJECTIONS
($ billions; fiscal years)

Date of Projection	Office of Management and Budget			Congressional Budget Office		
	1982	1983	1984	1982	1983	1984
Jul 1981	– 42.5	– 22.9	+ 0.5	– 29.6	+ 17.7	+ 76.3
Sep 1981	– 43.1	– 22.9	0.0	– 65.0	– 55.0	– 50.0
Feb 1982	– 98.6	– 91.5	– 82.9	– 109.0	– 157.0	– 188.0
Apr 1982	– 100.5	– 101.9	– 93.8	– 119.3	– 182.0	– 216.0
Jun 1982	–	–	–	– 113.8	– 116.4	– 104.6
Jul 1982	– 108.9	– 115.0	– 92.6	– 111.5	– 146.0	– 152.5

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. . . The Federal Budget Deficit . . .

This suggests that at least some of the uncertainty plaguing the financial markets stems from not just the size of prospective budget deficits, but also from the multitude of confusing deficit forecasts emanating from Washington—each more dire than its predecessor, and with few convincing explanations. To be sure, the Administration states that much of the increased red ink stems from what was for it an unanticipated recession. Tax receipts soften during recessions due to sluggish personal incomes and corporate profits growth, while government expenditures rise faster as countercyclical outlays for such programs as extended unemployment insurance are stepped up. In this regard, the current recession has been no different from any other.

Despite strenuous efforts to curb the growth of nondefense outlays, income security expenditures (which include Social Security, food stamps and unemployment compensation) ran eight per cent ahead of comparable year-earlier levels during the first nine months of fiscal 1982, or by about $1.5 billion per month. The Administration says that the 2.6 percentage point increase alone in the unemployment rate since July, 1981 will add approximately $55 billion to the deficit totals, while today's lofty interest rates will add another

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 8/4/82	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	140.953	– .267	+ 8.987
Loans to Depository Inst.	.680	+ .132	– .440
Float	2.284	+ .518	– .403
Total Reserve Bank Credit	153.500	+ .909	+ 7.806
Treasury Deposits with Federal Reserve Banks	3.644	+ .286	+ .683
Currency Outside Banks	131.490	+ .593	+ 7.389
Member Bank Reserves:			
Required	39.682	– .374	– .698
Excess (Deficiency)	.333	+ .001	+ .022
Total Reserves Held	40.015	– .373	– .676
Net Borrowed Reserves	.181	+ .153	– .401
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	97.888	+ 2.037	+ 3.868

Monetary Aggregates†		% Change Since Three Months Ago*	% Change Since Year Ago
M1	453.4	– .2‡	+ 5.2‡
M2 (July '82)	1,922.7	+ 8.9	+ 9.6
M3 (July '82)	2,319.7	+ 10.9	+ 10.3
L (March '82)	2,716.8	+ 11.2	+ 11.4

†Seasonally adjusted. *Seasonally adjusted annual rate. ‡Four-week moving average.

New York Money Market

Offering Rates 8/13/82	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	9.20%	10.30%	10.80%
* Federal Agencies	9.75	10.75	12.70
* Project Notes—Taxfree (46% Taxable Equivalent)	11.11	11.85	NA
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	11.30	11.90	12.88

‡Finance Company Paper—Prime		‡* Bankers' Acceptances	
5- 14 days	10.13%	Sep.	10.50%
15- 29 days	10.25	Oct.	10.70
30- 59 days	10.25	Nov.	10.95
60- 89 days	10.50	Dec.	11.20
90-179 days	10.50	Jan.	11.55
180-239 days	10.88	Feb.	11.20
240-270 days	10.88		

‡Industrial Paper—Prime			
30- 89 days	10.75%	†Federal Funds Effective Rate	10.30%
90-120 days	10.88		

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	2nd Q'82	$ 3,047	$ 2,996	$ 2,902
Gross National Product (1972 Dollars)*	2nd Q'82	$ 1,477	$ 1,471	$ 1,502
Percent Change, Annual Rate	2nd Q'82	1.7	– 5.1	– 1.5
Change in Consumer Prices (all urban consumers)*	Jun '82	12.0%	12.0%	8.4%
Change in Producer Prices*	Jul '82n	7.2%	12.0%	4.8%
Civilian Employment (Thousands of Persons)†	Jul '82	99,732	99,764	100,864
Unemployment as % of Civilian Labor Force†	Jul '82	9.8%	9.5%	7.2%
Personal Income*	Jun '82	$ 2,561	$ 2,553	$ 2,398
Leading Indicators Composite Index (1967=100)†	Jun '82	127.9	127.9	135.2
Industrial Production Index (1967=100) †	Jul '82n	138.1	138.2	153.9
Net Change in Consumer Installment Credit†	Jun '82n	$ 1.35	$ 1.40	$ 2.03
U.S. Merchandise Trade Balance †	Jun '82	–$ 3.44	–$ 3.29	–$ 3.28
Plant and Equipment Expenditures*	3rd Q'82	$328.04(a)	$336.77(a)	$328.25
Private Housing Starts (Thousands of Units)*	Jun '82	911	1,075	1,046
New Construction Expenditures*	Jun '82	$ 230.7	$ 227.7	$ 237.5
Total Business Inventories†	Jun '82n	$ 512.0	$ 510.4	$ 501.4
Total Business Sales†	Jun '82n	$ 344.5	$ 349.1	$ 356.3

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. a-Anticipated.

$20 billion. Together, high rates of unemployment and interest account for the bulk of the $90 billion add-on to the fiscal 1983 deficit, the Administration maintains.

While they may have been a by-product of the recession, it would appear that these deficits also caused the recession. By shocking the financial markets, these deficit projections caused interest rates to remain unusually high compared with the rate of inflation. In turn, this widened Washington's deficit by adding to the government's outlays for interest on the national debt. At the same time, they reduced tax revenues because of the recession that resulted from the inability of business to cope with record high real interest rates.

. . . Just Keeps Growing . . .

As for the major source of these deficits, it is largely due to two of Washington's biggest self-inflicted wounds: the massive cut in personal and corporate income taxes and the sharp increase in defense spending. Since taxes were cut a year ago delays in the expected rebound in private sector activity have ensured that they have not become self-financing as the Administration expected. Thus the cost to the Treasury in terms of foregone revenues could reach $140 billion by fiscal 1984, causing the deficit to be

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Negotiable Time CD's Weekly Reporting Banks			
Nationwide (7/28/82)	144,864	+ 2,075	+19,664
New York City (7/28/82)	36,922	+ 1,593	+ 6,042
Commercial Paper (7/28/82)	181,826	– 756	+30,771

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (7/28/82)	210,510	+ 79	+29,545
New York City (7/28/82)	59,316	– 151	+ 7,084

Total Loans Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (7/28/82)	488,218	+ 347	+46,230
New York City (7/28/82)	114,065	+ 574	+ 8,914

Financial Markets

	Friday 8/13/82	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	9.15%	– 1.57	– 6.12
180-Day Bills†	9.55	– 2.38	– 5.80
Longest Bills†	11.49	– .02	– 3.06
Recent Issues:			
13 1/8s 7/31/84	12.35	– .89	
14 7/8s 6/30/86	13.11	– .74	
13 3/4s 5/15/92	13.27	– .66	
14s 11/15/11	12.56	– .90	
Municipals:			
Bond Buyer–20 Bond Index* (8/12/82)	11.86%	– .01	– .08
Blue List Total ($ Million)	$ 949	+ $ 36	+ $178
30-Day Visible Supply ($ Million)	$1,818	– $472	– $190
Total	$2,767	– $436	– $ 12
Corporates:			
Moody's Aa Composite (8/12/82)	14.90%	+ .01	– .30
30-Day Visible Supply ($ Million) ‡	$1,125	– $275	NA
Stocks:			
Dow-Jones Averages:			
Industrials	788.05	+ 3.71	– 148.88
Transportation	295.49	– 1.57	– 113.38
Utilities	106.31	+ 1.80	– 8.36
65 Stocks	303.74	+ 1.19	– 68.02
Standard and Poor's 500 Stocks	103.85	+ 1.14	– 28.64
N.Y.S.E. Composite Index	59.54	– .15	– 17.46
N.Y.S.E. Avg. Daily Vol. for Week (000's)	50,214	– 4,040	+ 4,176

* 46% Taxable equivalent 21.96%.
‡ Series redefined: Historical data not available.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 8/13/82	Week Ago
Overnight	10.00%	10.63%
1 month	11.25	11.63
3 month	11.88	12.63
6 month	12.75	13.56
1 year	13.00	13.81
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 to 7 yrs.)	13.95%	14.15%
Long Term (7 to 15 yrs.)	14.20	14.35

FOREIGN EXCHANGE SPOT RATES

New York Opening (8/13/82)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.02096	47.72
Canada	.7973	1.2542
Denmark	.1152	8.6805
France	.1437	6.9590
Germany	.4004	2.4975
Italy	.0007175	1393.70
Japan	.003823	261.58
Mexico	.01404	71.25
Netherlands	.3636	2.7505
Switzerland	.4676	2.1388
U.K.	1.7110	.5845

larger than it otherwise would have been in the absence of such cuts. As a consequence, the Federal government finds itself absorbing more, not less, of the nation's scarce credit resources.

Even more distressing is the fact that while the $4 per week increase in the average worker's take-home pay is insufficient to spark a strong consumer-led rebound, it is large enough in the aggregate to push the Federal deficit to new record levels. On top of this have come the whopping increases in defense spending which have been promised; already they are running almost 20 per cent, or about $2.5 billion per month, above year-ago levels with huge increases slated well into the future.

If, indeed, the enormous projected deficits do hold up, Federal and Federal-related borrowings will probably absorb almost all of the net savings generated by the economy in 1983 (see MHT's Economic Report—April, 1982) and account for more than 50 per cent of total funds raised in the credit markets, both record-high levels. Even when expressed as a percentage of gross national product, the outlook is dismal, with total Federal and Federal-related borrowings expected to reach a postwar record of more than eight per cent in fiscal 1983.

. . . With Each New Forecast

It is against this backdrop that the financial markets are struggling to establish a firmer footing, businesses are desperately paring capital spending and inventories and consumers are pulling in their horns. And although welcome, the three-year tax increase package now under consideration is simply insufficient to restore Federal financial health: Twelve-digit budget deficits still seem likely.

One way to escape the current dilemma would be to close the self-inflicted wounds. Since the combination of hefty tax cuts and stepped-up defense spending is largely responsible for the anticipated budget deficits, scaling back either would go a long way toward reducing fiscal excess. Postponing only the third stage of the individual income tax cuts would pare the fiscal 1984 deficit to about $100 billion, while trimming the projected defense outlays of $255 billion in that year by only ten per cent would bring the deficit down into the $75 billion zone.

If such a program succeeded in reducing interest rates sufficiently to spark even a modest recovery and bring the unemployment rate back to July, 1981 levels, the remaining deficit would just about disappear. Budget balance in fiscal 1984? Not impossible if the Administration were to scrap its present program and start all over again. ■

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